Coachella Valley Housing Coalition

45-701 Monroe Street, Suite G, Plaza 1, Indio, CA 92201
TEL: (760) 347-3157 FAX: (760) 342-6466

March 2, 2005

Mrs. Ladeena Ford
State Board of Equalization
Property and Special Taxes Department
P.O. Box 942879
Sacramento, CA 94279-0064

Dear Mrs. Ford,

We understand that the BOE is undertaking a welfare exemption rule project for the purpose of adopting four new Property Tax Rules to implement statutory law pertaining to the welfare exemption. As part of its process, the Board has scheduled a meeting to discuss a number of issues prior to the drafting of the new rules. We would like to share our views on a number of the issues raised.

The welfare exemption is a critical piece of the financing mechanisms that help California meet its overwhelming affordable housing needs. It reduces operating costs for projects that provide a needed social benefit, in turn reducing the subsidy required of public entities. The Coachella Valley Housing Coalition (CVHC) has built 23 multi-family developments in Riverside County since 1986. The welfare exemption has allowed these projects to be successful because operating costs are feasible. If the welfare exemption did not exist, a large amount of additional funding would have to be leveraged by CVHC and by local governments. This significant increase in costs would reduce the number of affordable units in our community. CVHC currently provides more than 1,513 families and individuals with affordable and safe housing through our rental projects. All of our projects receive the property tax exemption. Without it, state and local governments would simply have to increase financial support for projects or fund fewer projects in the future, further exacerbating an acute crisis for those in need.

It is our strong belief that properties that initially qualify for a welfare exemption should continue to receive the welfare exemption through the life of the regulatory agreements. While the tax credit period may expire after ten years and mortgage revenue bonds are repaid after 30 years, affordability is nevertheless restricted on these projects for a period of 55 years and the public is benefiting from 55 years of affordability. The projects should receive the welfare exemption for the same amount of time.

Ultimately, it is our belief that an eligible owner should receive the welfare exemption for any project with qualifying affordability covenants imposed by a public entity regardless of the source of subsidy.

We believe that these positions are consistent with current law and strongly urge the Board, to the extent that new rules are even required, to adopt rules that are consistent with these views.

The Coachella Valley and all of California have a great need for affordable housing. Looming federal and state budget cuts and increasing housing costs threaten many existing sources of funding for new developments and ongoing costs of operating affordable housing projects. Access to the welfare exemption must remain intact in order to make sure that CVHC and CDCs throughout the state are able to continue developing affordable housing to meet the needs of low-income Californians.

Sincerely,

John F. Mealey
Executive Director

Community HousingWorks

Building Communities. Changing Lives.

March 4, 2005

VIA FACSIMILE
916-323-8763

Mr. Dean Kinnee, Chief
State Board of Equalization
Property and Special Taxes Department
Assessment Policy and Standards Division
450 N Street
Sacramento, CA 94279-0064

Re: Comments on Proposed Changes to Welfare Exemption Rules140-143

Dear Mr. Kinnee,

I am writing on behalf of the Community HousingWorks (CHW) in support of the proposed changes BOE is considering making to the Welfare Exemption Rules 140-143.

Community HousingWorks develops and maintains quality affordable housing, creates home ownership opportunities, supports local leaders, and provides community-based education and services, in order to strengthen communities and increase the financial independence of families and people in need. Community HousingWorks has a successful history as a multifamily developer in urban, suburban and rural communities in San Diego, with some 1000 apartment homes and cooperatives in 23 complexes, and over 300 new homes in the development pipeline.

The welfare exemption plays a critical role in the financial feasibility all of the housing developments we have worked on. There is no question that without the exemption there would be significantly fewer units of affordable housing and those that remained would not be able to serve people who need the assistance most. We are aware, however, of a number of cases in which we believe the exemption is being used in ways that are not consistent with the intent of Revenue and Taxation Code Section 214(g) governing the use of the exemption

1820 South Escondido Blvd., Suite 101, Escondido, CA 92025
Phone: 760-432-6878 Fax: 760-432-6883

4305 University Avenue, Suite 550, San Diego, CA 92105
Phone: 619-282-6647 Fax: 619-640-7119

www.communityhousingworks.org

by limited partnerships with a nonprofit managing general partner. For this reason, we are particularly interested in commenting on Issue 7 relating to the proposed changes to Rule 140.

Our intent in commenting on this is not to point fingers at particular organizations or to urge BOE to take away exemptions that have already been granted, but rather to urge you to strengthen and clarify the requirements with respect to the management authority and duties of a nonprofit managing general partner so that a bright line is established that the entire industry can clearly see and that county assessors can monitor and enforce with BOE assistance.

The following are our comments on the specific staff positions outlined in the Febraury 24 memorandum to interested parties:

1. **Exemption qualification of tax credit properties.** We agree with the staff position that properties receiving tax credits should be eligible for the exemption for the duration of the longest regulatory agreement that meets BOE criteria. It is the regulatory agreement limiting the benefit of the exemption to low income households that should be considered for determining eligibility, not any financing mechanisms.

2. **Exemption qualification of properties that have refinanced government loans.** Properties should remain eligible for exemption as long as there is a recorded regulatory agreement in place restricting income and rents in accordance with BOE regulations.

3. **Exemption qualification of properties with federally insured loans.** We support the staff position that only those federally insured loans with recorded regulatory agreements should satisfy the "government financing" criteria under section 214(g)(1)(A). Financing should not determine whether an exemption is allowed; the regulatory agreement should.

4. **Amount of exemption allowed per property.** We disagree with the staff position that the exemption should be limited to the percentage of low income units specified in the regulatory agreement(s). We believe that all units under 80%of median income should qualify for the tax exemption as is currently the rule. Many affordable housing complexes use bonds and include 80/20 combinations of income mixes with 80% at market and 20% below 50%. Community HousingWorks uses this structure to create mixed -income communities where the 80%is at or below 80% of median income. Today, these 80% AMI units qualify for tax exemption. These developments are worthy of tax exemption as the rents remain far below

market and contribute to a mixed-income community and more and more jurisdictions are asking affordable housing developers to incorporate a mix of incomes to create more Balanced Communities. If this rule is changed, Community HousingWorks would literally have to increase rents on apartments that we now secure at 80% or below and, potentially move families out of their homes, in order to afford to pay the increase in property taxes.

5. **Exemption qualification of property with multiple agreements.** We agree with the staff position that where there are multiple regulatory agreements governing a single project, the agreements should be combined to determine the percentage of units eligible for exemption.

6. **Exemption qualification of projects with section 8 tenant vouchers.** We agree with the staff position that units occupied by individuals with section 8 vouchers but not otherwise governed by a regulatory agreement should not be qualified for the exemption. Similarly, we believe that units governed by project-based HAP contracts should be eligible *as long as they are also governed by recorded regulatory agreements* that maintain affordability to low-income households in the event that the Section 8 subsidy is terminated.

7. **Requirements for the nonprofit managing general partner.** We agree with the staff position that non-profit managing general partners must have management authority that it actually exercises, rather than merely functioning as a "shell" for the purpose of obtaining the exemption. The intent of the underlying law is clear that (1) the benefit of the exemption should be used to keep rents low, not to enrich any of the parties to the transaction; and (2) that the Legislature wanted only nonprofits with the staff and capacity to actually manage the partnership to trigger eligibility, not nonprofits set up primarily to obtain the exemption or social service nonprofits without the capacity to actually manage the partnership.

8. **Qualifying rent levels.** We support the staff position that projects which operate consistent with the regulatory agreement governing maximum rent and income levels should be eligible for exemption and that lower rents are not needed.

Thank you for considering our positions. Feel free to call me with any questions.

Sincerely,

June B. Wilson

Anne B. Wilson
Director, Housing and Real Estate Development

Ford, Ladeena

From: Martha Putnam [mputnam@thecorecompanies.com]
Sent: Friday, March 04, 2005 3:22 PM
To: Ford, Ladeena
Subject: welfare exemption under 214 (g)

Ladenna Ford

State Board of Equalization

Sacramento, CA

March 4, 2005

<<BOE 214(g) Position Paper.doc>>

RE: Proposed Welfare Exemption Rules

Dear Ms. Ford:

Unfortunately I will be out of town during the Meeting on March 16, but I did want to comment on the proposed changes to the State Welfare Exemption System.

It is critical that the system for achieving welfare exemption under 214 (g) for partnerships in which a nonprofit corporation serves as the managing general partner, remain predictable. And, it works well now, with the ability to choose a property management company based on its competence, not its status as a nonprofit or a for profit corporation. I oppose the self-interested efforts of those industry critics who are urging the BOE to make the welfare exemption more difficult to administer and less predictable to project. I strongly urge the BOE to carefully consider the potential effect of changing the present rules.

It works well now, since most investors feel that the property tax exemption in California is predictable. If they didn't underwrite the welfare exemption, we would of course be forced to build less affordable housing, because each unit built would be much more expensive to build without the exemption. Many of the service-based nonprofits are terrific at providing services, however, when it comes to the required financial reporting required from tax credit investors and the strict lease-up criteria and schedules, it is often more efficient to have everyone specialize in what they do best, by having the Managing General Partner asset manage the property and oversee a property management company, rather than try to have each nonprofit Managing General Partner be forced to become a property management company. If you change the system and make it less predictable, then investors will be less inclined to invest in California transactions and the end result will probably be that much more public subsidy will be needed in order to make affordable housing projects work without the competition.

I believe that the accusations of abuse of the system are groundless and based on gossip. From the people creating affordable housing that I have met, I have seen nothing but a desire to produce the best possible housing at the lowest level of affordability possible. If there is a specific case of suspected fraud, my understanding is that you and/or any county assessor that suspects this is the case have the right to an audit already, correct? And, can't then you work within the present guidelines to eliminate any existing problems rather than rewrite the system?

In the event you feel it necessary to change the regulations, it is imperative that you appoint a committee of industry

experts to study the issue, including people active in the financing of these projects (i.e. actual investors and lenders) who understand the entire issue.

I know your task is not an easy one, but the system works well and I fear anything that would damage an already challenged affordable housing industry. I believe that with the BOE's system and their right to audit and the county assessor's right to audit, along with the tax credit investors and lenders stringent oversight, assures that the Managing General Partners will continue to exercise critical management authority over the projects in which they are Managing General Partners.

In closing, I would like to express my support for the BOE staff's positions outlined in the BOE's February 24 follow-up letter signed by Dean R. Kinnee. I am enclosing for your review Cox, Castle and Nicholson LLP's policy paper on the proposed welfare exemption rules. I endorse CCN's reasoning and conclusions.

Sincerely,

Martha Putnam
c/o The Core Companies
-A Group of Independent Companies
470 South Market Street
San Jose, CA 95113
408.292.7841 x15 phone
408.292.0339 fax
Cell: 408-828-3204
mputnam@thecorecompanies.com
www.thecoreccompanies.com

COX CASTLE NICHOLSON

POLICY PAPER:
CALIFORNIA STATE BOARD OF EQUALIZATION
PROPOSED WELFARE EXEMPTION RULES
March 4, 2005

This policy paper addresses a major affordable housing issue identified in the California State Board of Equalization's (the "BOE's") January 14, 2005 letter concerning proposed new "welfare exemption" rules. Issue #7 identified in the BOE's January 14 letter relates to what authorities and duties should be required of a qualifying "managing general partner" under California Revenue and Taxation Code ("R&T") Section 214(g)(1). This paper addresses the managing general partner concept and, at a more general level, discusses the BOE's current regime for administering R&T Section 214(g) ("Section 214(g)").

Specifically, this paper:

- Describes how affordable housing developments are financed today in California.
- Reviews the history and purpose of 214(g).
- Analyzes some of the more radical suggestions for change and points out the dangers of such radical reform.
- Concludes that the current BOE-administered system is achieving the California legislature's goal of increasing the state's affordable housing stock and supports the BOE's current administrative regime for managing the 214(g) welfare exemption.

EXECUTIVE SUMMARY

The BOE has developed a sound administrative process for implementing the welfare exemption granted under 214(g) to partnerships in which a nonprofit corporation serves as the managing general partner. The BOE's self-certification system – whereby a managing general partner of a project-owning partnership must certify, under penalty of perjury, that it has certain enumerated, substantial management authority and duties befitting a "managing" general partner – is true to the text of, and the legislative intent behind, 214(g). It strikes the proper balance between encouraging development of affordable housing in California, on the one hand, and regulating the use of the welfare exemption, on the other hand.

Contrary to the suggestions of certain critics of the BOE's compliance regime, there is no evidence that for-profit developers regularly manipulate nonprofits to abuse the welfare exemption. Even if there was an indication of individual instances of such abuse, the BOE and the county assessors (who jointly administer the welfare exemption system) already have the authority to audit suspected offenders and deny or revoke welfare exemptions.

The welfare exemption is a vital element in sustaining the financial viability of virtually every affordable housing development in California. The financial institutions that provide the vast majority of the equity and debt financing for these projects are willing to size their investments based on the expectation that a properly structured and managed project will qualify for a welfare exemption. These financial institutions now rely on the BOE system and appreciate the fact that it is predictably, consistently and efficiently managed by the BOE staff. The BOE should carefully consider any proposal for reforming the present system. Any change to the present system risks creating uncertainty in the financial community, which may result in a direct loss of affordable housing.

ANALYSIS

How Privately-Owned Affordable Housing Developments are Financed Today; How Lenders and Investors Police Welfare Exemption Compliance

(1) Overview of the System

California has a housing crisis. The evidence for this crisis is compelling and overwhelming. As the California Department of Housing and Community Development ("HCD") reported in its May, 2000 study entitled "Raising the Roof: California Housing Development Projections and Constraints, 1997 – 2020":

> "California will need an unprecedented amount of new housing construction—more than 200,000 units per year through 2020—if it is to accommodate projected population and household growth and still be reasonably affordable. It will need more suburban housing, more infill housing, more ownership housing, more rental housing, more affordable housing, more senior housing, and more family housing."

This paper focuses on the manner in which developers (for profit and nonprofit), lenders and investors have responded to the affordable housing portion of the California housing crisis. While there are larger social factors that have contributed to the affordable housing crisis, much of it is attributable to market factors that make it extremely difficult for affordable housing developers to compete with market rate developers for suitable multi-residential properties. In response, affordable housing development has become increasingly reliant upon a complex financial structure that leverages tax exempt bond financing, publicly subsidized financing, low income housing tax credits, and the welfare exemption.

A unique attribute of affordable housing finance is the involvement of large financial institutions in all aspects of affordable housing development. Some of the nation's largest and most reputable financial institutions are actively involved as lenders and/or equity investors in affordable housing in California. The participation by these institutions offers unique assurances that affordable housing programs, including the welfare exemption, are properly monitored and utilized. At the same time, these financial institutions require predictability and efficiency as to the availability of housing incentives such as the welfare exemption, if they are to underwrite such programs into the financing structure.

In practice, the welfare exemption is absolutely essential in maintaining affordability. The welfare exemption decreases the expenses associated with the ownership and operation of an affordable housing development, and therefore increases the size of the loans that lenders are willing to offer to project owners. Indeed, it is difficult for lenders to underwrite their loans for affordable housing projects without the property tax exemption. The Senate Revenue & Taxation Committee, in its July 15, 1987 hearing to consider the bill that was later codified as Section 214(g), recognized this financial reality, acknowledging that "some prospective low income projects may not 'pencil out' without the property tax exemption" (emphasis added).

(2) Tax Credits

In order to take full advantage of the low income housing tax credit authorized by Internal Revenue Code Section 42, the overwhelming majority of for-profit and non-profit developers in California utilize a limited partnership structure to own and operate affordable housing developments. A well-established, institutional tax credit investor (often a Fortune 500 company) or a syndicated fund of such investors make an equity investment in the limited partnership in exchange for virtually all the low income housing tax credits generated by a project. The tax credit investor utilizes the tax credits to offset federal taxes on a dollar-for-dollar basis over a 10-year period, and, therefore, is willing to make capital contributions to the project-owning partnership for these credits.

(3) Tax-Exempt Bond Financing

An affordable housing project developer often uses debt financed the issuance of low-interest, tax-exempt bonds, usually in addition to tax credits. Typically, a California state or local governmental entity issues private-activity multifamily housing revenue bonds under the state's bond volume cap, and loans the proceeds of those bonds to the project-owning partnership, receiving a deed of trust on the property as security. Tax-exempt multifamily housing revenue bonds are either publicly-offered or privately-placed.

Where such bonds are publicly-offered, investors with no firsthand knowledge of the project or the project-owning partnership purchase the bonds. Such distribution is handled by an investment banking firm with mandated obligations to utilize due diligence in any distribution of securities. Such investment bankers focus on the ability of the affordable housing project to service the repayment obligations on the bonds. Thus, these investment bankers are uniquely

focused on the underwriting standards for expenses, including the availability of the welfare exemption.

At the same time, in order to keep the interest rate on such bonds low, a credit-enhancer (typically a major national bank or financial institution) offers a letter of credit or other form of guaranty that the bonds will be repaid, even if the affordable housing project underperforms expectations and the project-owning partnership fails to repay the loaned bond proceeds. The credit enhancer thus plays the role of the real estate lender, taking all of the real estate-related risk, and conducting due diligence (including review of the availability of the welfare exemption) similar to the investment bankers' review.

Where such bonds are privately-placed, a well-established lender (typically a major national commercial bank or national financial institution) will purchase all of the bonds and loan the proceeds directly to the project-owning partnership. These lenders conduct extensive underwriting due diligence, including review of the availability of the welfare exemption.

(4) Conventional Financing and/or Loans from Governmental Agencies

Some developers choose not to obtain tax-exempt bond loans, and instead utilize conventional real estate loans (typically from a major national or regional bank) or loans from federal, state or local agencies. Sometimes a developer will obtain both a conventional loan and one or more loans from government agencies. These loans go through the same underwriting (including review of welfare exemption availability) and due diligence scrutiny as discussed above for tax-exempt bond loans.

(5) Conclusion: How Lenders and Investors Police the Property Tax Exemption

As discussed above, the tax credit equity investors, tax-exempt bond credit enhancers/lenders and conventional lenders that provide the lion's share of affordable housing project financing are some of the largest and most sophisticated financial institutions in the world. These investors and lenders subject affordable housing projects to intense underwriting scrutiny at the outset, and intense compliance oversight on an ongoing basis.

Without a predictable welfare exemption, obtainable in a timely manner, lenders would not include welfare exemption savings into their underwriting, making affordable housing projects next to impossible to finance. Moreover, in order to ensure that project-owning partnerships can afford to cover the debt service on loans underwritten to include welfare exemption savings, these lenders provide ongoing welfare exemption compliance oversight, thus providing a backstop to the BOE's and assessors' roles in policing against welfare exemption fraud.

Moreover, the BOE's managing general partner regime requires tax credit equity investors to cede a certain amount of power to nonprofits. These Fortune 500 financial institutions require strict statutory compliance by their partners (including the managing general partner), as a necessary element in protecting their equity investments in affordable housing projects. Contrary to the insinuations of the current regime's critics, these institutional tax credit

investors would not enter into a written agreement granting substantial management powers to a nonprofit, and then blithely ignore that agreement in practice.

History and Purpose of R&T 214(g)

Section 214 was enacted in 1945 to implement Section 4(b) of Article XII of the California Constitution, which provides that the California legislature may exempt from taxation "property used exclusively for religious, hospital or charitable purposes and owned or held in trust by corporations or other entities." The original policy rationale for enacting Section 214's "welfare exemption" was to treat certain privately owned property, which was used to provide a charitable activity, in the same manner as publicly owned property which would otherwise be used by government to perform that same charitable function.

(1) Managing General Partner

(a) General Discussion.

In furtherance of the spirit of the exemption, Section 214 was amended in 1987 to add subsection (g), which provides that:

> "[p]roperty used exclusively for rental housing and related facilities and owned and operated by religious, hospital, scientific, or charitable funds, foundations, or corporations, *including limited partnerships in which the managing general partner is an eligible nonprofit corporation . . .*"

shall be entitled to a full or partial property tax exemption, subject to the conditions set forth in Section 214(g) (emphasis added).

The participation of an eligible nonprofit corporation, either as the owner of the property or as the managing general partner of a limited partnership that owns the property, is constitutionally necessary. Without the participation of a nonprofit corporation, the welfare exemption granted by Section 214(g) would not comply with the tax exemption requirement set forth in California Constitution Section 4(b) of Article XII of the California Constitution.

In adopting 214(g), the California Legislature did not focus its attention on the attributes of a "managing general partner." Indeed, the highlighted language quoted two paragraphs above was inserted into the proposed text of Section 214(g) a mere twenty-one days before Governor George Deukmejian signed it into law.

The legislative history shows no debate accompanying the addition of the managing general partner concept. Rather, the legislative history reveals a debate focused almost exclusively on the benefit of increasing California's stock of affordable housing, on the one hand, versus the cost associated with the loss of property tax revenues, on the other hand. The addition of the managing general partner concept into 214(g) appears to have been an

extension of the economic reasoning behind the bill, summarized succinctly by the Senate Revenue & Taxation Committee in its July 15, 1987 hearing on 214(g):

> "The justification for the exemption would be that the funds which are currently paid in property taxes could better be used in furtherance of the goals of providing low income housing. Also, it may be that some prospective low income projects may not 'pencil out' without the property tax exemption."

(b) What is a "Managing" General Partner?

Notably, the legislature chose the phrase "managing general partner" rather than "general partner." The California Revised Limited Partnership Act contains extensive provisions setting forth the obligations of a "general partner," but makes no mention of a "managing" general partner. By choosing to use the term "managing" general partner, the legislature clearly indicated its understanding that property-owning partnerships could have other, for-profit general partners, so long as the nonprofit general partner was the "managing" general partner.

Certain affordable housing developers have suggested to the BOE that "managing general partners" should be required to provide an expanded array of operational assistance at low income housing projects. These developers have further indicated that this assistance can only be provide by nonprofit organization who are well-capitalized and have extensive staffs. If this recommendation were to be implemented, it would limit the number of qualified organizations to a very few developers and clearly undercut the intent of 214(g).

This suggestion also denigrates the many well-established and well-qualified nonprofits who are small organizations but have demonstrated the capability to develop and operate from one to a multiplicity of affordable housing projects. These organizations have accomplished this by hiring a few staff and retaining experienced property management companies and consultants. If the BOE were to impose a "litmus test" that defined a "managing general partner" according to an organization's balance sheet and/or staffing level, it would seriously undercut, if not destroy, the ability of these nonprofits to contribute to the development of affordable housing in California.

The legislative history also demonstrates a governmental sensitivity to the need to support continued participation by underfunded nonprofit organizations in affordable housing development, and a recognition that the welfare exemption would provide that support. In its Enrolled Bill Report, submitted in late September, 1987, the HCD recognized that nonprofit organizations suffer from "limited budgetary conditions." The HCD report goes on to state that the final proposed text of 214(g)would address "the Governor['s] expressed interest in . . . preserving affordable housing and assuring a continued role for nonprofits in affordable housing."

Nonprofit participation in affordable housing is as important today as it was in 1987, and therefore the BOE should resist pressure from an exclusive group of nonprofits calling

for rule changes that would increase the expense of nonprofit participation in affordable housing projects.

(2) Use of Property Tax Savings

Under Section 214(g), the owner of the property must:

> "[c]ertify that the funds that would have been necessary to pay property taxes are used to maintain the affordability of, or reduce rents otherwise necessary for, the units occupied by lower income households."

On August 18, 1987, the State Assembly amended the bill that was later codified as Section 214(g) to provide that property owners should only be required to *certify*, rather than affirmatively *demonstrate*, that the property tax savings are actually helping to maintain affordability or reduce rents. In its August 26, 1987 bill analysis, the BOE emphasized the expense of administering a requirement that a property owner affirmatively demonstrate compliance, and explained that "[i]t is not clear how the owner of the property could demonstrate that this requirement is satisfied."

By adopting a "certification" standard rather than the earlier-proposed "demonstration" standard, the Legislature moved away from requiring property owners to file financial information. Such a system would have imposed a nearly impossible burden on owners to track – perhaps on a dollar-for-dollar basis – how property tax savings are applied.

Moreover, 214(g) allows owners to certify that the property tax savings are used to maintain affordability *or* reduce rents. This standard, together with the self-certification regime, evidences the Legislature's desire to steer clear of managing exactly how affordable housing projects are run and exactly how property tax savings are applied. Instead, the Legislature focused on the broader goal of providing financial assistance for purposes of maintaining and increasing California's stock of affordable rental housing.

In practice, the welfare exemption is absolutely essential in maintaining affordability. As discussed above, the welfare exemption decreases the expenses associated with the ownership and operation of an affordable housing development, and therefore increases the size of the loans that lenders are willing to offer to project owners. Indeed, it is difficult for lenders to underwrite construction and permanent loans for affordable housing projects without the property tax exemption.

Radical Reforms Are Ill-Advised

Since the BOE's reform proposal was announced in January, 2005, a very small but vocal element has suggested that there is systemic and widespread abuse of the welfare exemption. While this is a dramatic proposition, there is simply no evidence whatsoever of such abuse. Indeed the only "evidence" to date consists of anecdotal, third-hand statements by a few

members of the public regarding singular examples of perceived abuse. While the BOE should certainly take accusations of fraud seriously, it would be rash to suggest that a few such allegations warrant wholesale changes to the present system.

Another theme running through some of the vocal criticism of the present system is the implicit suggestion that some nonprofits are less worthy than others. This criticism is essentially a "straw man" argument. It diverts attention from the real public policy issue at hand, namely meeting the legislature's mandate for the production of more affordable housing, and tries to focus attention on the perceived qualities of certain nonprofits. This is an entirely subjective and relative matter. There is no litmus test for what is a nonprofit, nor should one be imposed. Moreover, such a consideration is outside of the mission of the BOE and would unnecessarily burden the BOE's already overused resources. The Internal Revenue Service ("IRS") and California's Franchise Tax Board ("FTB") are the appropriate authorities for such determinations, and these agencies already vet prospective nonprofits at the outset, before such entities can even consider becoming involved in the welfare exemption process. Indeed, the BOE's proposed Rule 140 requirements regarding BOE review of a nonprofit's "charitable" purposes, as presented at the BOE public meeting on March 2, 2005, are wholly duplicative of IRS and FTB responsibilities and, therefore, are unnecessary.

A final suggestion proffered by a few critics is that only nonprofits involved in the physical operation of an affordable housing project merit the welfare exemption. Presumably, only nonprofits with their own management companies or construction companies could ever meet a stringent application of this test. That proposed standard is entirely inappropriate. The welfare exemption has never been construed to require such ground level involvement, as discussed in the legislative history section above. Rather, essential management and oversight, as required by the BOE's present system, is the critical test. Requiring a nonprofit to have extensive assets and capital is antithetical to the legislative history, which noted that nonprofits suffer from "limited budgetary conditions."

The Current BOE-Administered System is Achieving the Goals of 214(g)

The current BOE-administered system for assuring compliance with 214(g), as set forth in the BOE's Assessor's Handbook Section *Welfare, Church and Religious Exemptions*, is achieving the original purpose of 214(g): namely, to increase California's stock of affordable rental housing. The BOE's proposed Rule 140, as presented at the March 2 public meeting, would amend the present system by adding additional requirements that are, at heart, substantially similar to the present requirements. The BOE should carefully consider the cost associated with making changes to the present system. Unless change is urgently needed (and this paper has argued that it is not needed), and unless the proposed changes would fundamentally reform the present system (and this paper has argued that the changes proposed by Rule 140 do not), then the BOE should carefully consider the administrative cost of tinkering with a system that already predictably and efficiently achieves the legislature's goals.

With respect to "managing general partner" duties, the BOE's self-certification standard – whereby a managing general partner of a project-owning partnership must certify, under

penalty of perjury, that it has certain enumerated management authority and the substantial duties befitting a "managing general partner" – is in keeping with the legislative intent behind 214(g). As discussed above, the legislature consciously chose to adopt a "*certification*" system rather than a "*demonstration*" system for assuring compliance with 214(g)'s requirement that property tax savings be applied towards reducing rents or maintaining affordability. The BOE's managing general partner self-certification standard stays true to the original legislative intent behind 214(g): increasing California's affordable housing stock, rather than imposing governmental control over exactly how affordable housing projects are run.

Further, since 214(g) does not discuss a managing general partner's duties or attributes, there is no clear legislative authorization for the BOE to expand the reasonable list of duties that managing general partners are required presently to attest to on forms BOE 267-L1 and BOE 277-L1. Indeed, the suggestion from a few critics of the current self-certification regime that it allows "nonprofit shells" to obtain property tax exemptions on behalf of for-profit developers is not only factually incorrect – it also runs counter to the very purpose of 214(g).

However, should either the BOE or a county assessor suspect that a particular managing general partner is failing to exercise the managerial control that it is certifying to on forms BOE 267-L1 or BOE 277-L1, both the BOE and the county assessor have the right to audit the potentially offending parties. Forms BOE 267-L1 and BOE 277 L-1 both clearly alert a filing non-profit of this fact, stating in bold letters: "**Welfare Exemption claims and supporting documents are subject to audit by the Board of Equalization and by the Assessor.**" Therefore, in response to any suggestion from critics that some fraudulent managing general partners are abusing the welfare exemption system, the BOE and the county assessors can and should emphasize that they have the power to audit any and all limited partnerships that obtain a welfare exemption, and the power to revoke improperly obtained welfare exemptions.

Also, from an economic efficiency standpoint, if the property tax exemption is to be accounted for in a lender's initial underwriting, it must be knowable, predictable, and timely obtained. In an era where tax credit investors, credit enhancers and conventional lenders make long-term financial commitments to each affordable housing project that they finance, the predictability of the BOE's bright-line certification process provides a necessary source of predictability. Without that predictability, financial institutions would not count on the availability of property tax savings, and would reduce the amount of money that they would be willing to lend and/or invest in affordable housing projects. Any decrease in available financing would only worsen the ability of developers to try to meet California ever-increasing need for affordable rental housing.

The BOE's certification system (supported by the BOE's and the county assessors' audit rights), when coupled with the strict, ongoing oversight provided by tax credit investors, credit enhancers and conventional lenders, assures that managing general partners will continue to wield essential management authority, rather than operating as a "nonprofit shell" for the purposes of obtaining the property tax exemption.

Lastly, the authors of this policy paper would like to support the BOE staff's positions outlined in the BOE's February 24 follow-up letter signed by Dean R. Kinnee. The authors of

this paper support the BOE's ongoing efforts to add predictability to all remaining unsettled areas of 214(g) administration and practice.

Stephen C. Ryan, Chair
Affordable Housing Practice Group
Cox, Castle & Nicholson
555 Montgomery Street, 15th Floor
San Francisco, California 94111

The CORE Companies

A Group of Independent Companies

March 4, 2005

California State Board of Equalization
Property and Special Taxes Department
450 N Street
P.O. Box 942879
Sacramento, California 94279
Attn: Mrs. Ladeena Ford

Re: Comments to Proposed Welfare Exemption Rules

Dear Madam/Sir:

I am writing to voice my support for the Board of Equalization's present system for administering the property tax exemption under California Revenue and Taxation Code, Section 214(g) for partnerships in which a nonprofit corporation serves as the managing general partner.

The welfare exemption is critical to the development of affordable housing in California. Over the years, the BOE has successfully developed a system for reliably and efficiently administering the welfare exemption. The present system is working. If anything, California needs to make it easier to finance and develop affordable housing, not harder.

I oppose the self-interested efforts of those industry critics who are urging the BOE to make the welfare exemption more difficult to administer and less predictable to project. I strongly urge the BOE to carefully consider the potential effect of changing the present rules.

I am enclosing for your review Cox, Castle and Nicholson LLP's policy paper on the proposed welfare exemption rules. I endorse CCN's reasoning and conclusions.

Sincerely,

Jovia Neale

CORE DEVELOPMENT INC / CORE GENERAL CONTRACTOR INC / CORE HOMES LLC / CORE AFFORDABLE HOUSING LLC
THE HISTORIC HERROLD BUILDING (Circa 1918)
470 SOUTH MARKET STREET / SAN JOSE / CA 95113 / 408.292.7841 / FAX 408.292.0339

COX CASTLE NICHOLSON

POLICY PAPER:
CALIFORNIA STATE BOARD OF EQUALIZATION
PROPOSED WELFARE EXEMPTION RULES

This policy paper addresses a major affordable housing issue identified in the California State Board of Equalization's (the "BOE's") January 14, 2005 letter concerning proposed new "welfare exemption" rules. Issue #7 identified in the BOE's January 14 letter relates to what authorities and duties should be required of a qualifying "managing general partner" under California Revenue and Taxation Code ("R&T") Section 214(g)(1). This paper addresses the managing general partner concept and, at a more general level, discusses the BOE's current regime for administering R&T Section 214(g) ("Section 214(g)").

Specifically, this paper:

- Describes how affordable housing developments are financed today in California.
- Reviews the history and purpose of 214(g).
- Analyzes some of the more radical suggestions for change and points out the dangers of such radical reform.
- Concludes that the current BOE-administered system is achieving the California legislature's goal of increasing the state's affordable housing stock and supports the BOE's current administrative regime for managing the 214(g) welfare exemption.

EXECUTIVE SUMMARY

The BOE's current regime for monitoring the 214(g) welfare exemption for partnerships in which a nonprofit corporation serves as the managing general partner is a success. The BOE's self-certification system – whereby a managing general partner of a project-owning partnership must certify, under penalty of perjury, that it has certain enumerated, substantial management authority and duties befitting a "managing" general partner – is true to the text of, and the legislative intent behind, 214(g). It strikes the proper balance between encouraging development of affordable housing in California, on the one hand, and policing the use of the welfare exemption, on the other hand.

Contrary to the suggestions of certain critics of the BOE's compliance regime, there is no evidence of for-profit developers manipulating nonprofits to abuse the welfare exemption. Even

if there was an indication of individual instances of such abuse, the BOE and the county assessors (who jointly administer the welfare exemption system) already have the authority to audit suspected offenders and deny or revoke welfare exemptions.

The welfare exemption is a vital element in the financial feasibility of virtually all affordable housing development in California. The financial institutions that provide the vast majority of the equity and debt financing for these projects are willing to size their investments under the assumption that a properly structured and managed project can indeed obtain a welfare exemption. These financial institutions have come to trust the BOE's system and appreciate the fact that it is predictably, consistently and efficiently managed by the BOE staff. The BOE should carefully consider any proposal for reforming the present system. Any change to the present system risks creating uncertainty in the financial community, which may result in a direct loss of affordable housing.

ANALYSIS

How Privately-Owned Affordable Housing Developments are Financed Today; How Lenders and Investors Police Welfare Exemption Compliance

(1) Overview of the System.

This paper assumes that California has an affordable housing crisis. The evidence for this assumption is compelling and overwhelming, and need not be rehashed in this paper. Instead, this paper focuses on the manner in which developers (for profit and nonprofit), lenders and investors have responded to that crisis. While there are larger social factors that have contributed to the affordable housing crisis, much of the crisis has been brought about by market factors that make it extremely difficult for affordable housing developers to compete with market rate developers for suitable multi-residential properties. In response, affordable housing development has become increasingly reliant upon a complex financial structure incorporating low income housing tax credits, tax exempt bond financing and property tax savings from the welfare exemption.

A unique attribute of affordable housing finance is the involvement of large financial institutions in all aspects of affordable housing development. Some of the nation's largest and most reputable financial institutions are actively involved as lenders or equity investors in affordable housing in California. The participation by these institutions offers unique assurances that affordable housing programs, including the welfare exemption, are properly monitored and utilized. At the same time, these financial institutions require predictability and efficiency as to the availability of housing incentives such as the welfare exemption, if they are to underwrite such programs into the financing structure.

In practice, the welfare exemption is absolutely essential in maintaining affordability. The welfare exemption decreases the expenses associated with the ownership and operation of an affordable housing development, and therefore increases the size of the loans that lenders are willing to offer to project owners. Indeed, it is difficult for lenders to underwrite their loans for

affordable housing projects without the property tax exemption. The Senate Revenue & Taxation Committee, in its July 15, 1987 hearing to consider the bill that was later codified as Section 214(g), recognized this financial reality, acknowledging that "some prospective low income projects may not 'pencil out' without the property tax exemption" (emphasis added).

(2) Tax Credits

In order to take full advantage of the low income housing tax credit incentive program offered by the federal government under Section 42 of the Internal Revenue Code, the overwhelming majority of for-profit and non-profit developers in California utilize a limited partnership structure to own and operate affordable housing developments. Typically, a well-established, institutional tax credit investor (typically a Fortune 500 company) or a syndicated fund of such investors makes an equity investment in the limited partnership in exchange for all of the low income housing tax credits generated by the project. The tax credit investor utilizes the tax credits to offset federal taxes on a dollar-for-dollar basis, and is therefore willing to make a capital contribution to the project-owning partnership for these credits.

(3) Tax-Exempt Bond Financing

An affordable housing project developer often seeks out debt financing in the form of a low-interest, tax-exempt bond loan, sometimes in addition to tax credits, sometimes without tax credits. Typically, a California state or local governmental entity issues private-activity multifamily housing revenue bonds under the state's bond volume cap, and loans the proceeds of those bonds to the project-owning partnership, receiving a deed of trust on the property as security. Tax-exempt multifamily housing revenue bonds are either publicly-offered or privately-placed.

Where such bonds are publicly-offered, investors with no first-hand knowledge of the project or the project-owning partnership purchase the bonds. Such distribution is handled by an investment banking firm with mandated obligations to utilize due diligence in any distribution of securities. Such investment bankers focus on the ability of the affordable housing project to service the repayment obligations on the bonds. Thus, these investment bankers are uniquely focused on the underwriting standards for expenses, including the availability of the welfare exemption.

At the same time, in order to keep the interest rate on such bonds low, a credit-enhancer (typically a major national bank or financial institution) offers a letter of credit or other form of guaranty that the bonds will be repaid, even if the affordable housing project underperforms expectations and the project-owning partnership fails to repay the loaned bond proceeds. The credit enhancer thus plays the role of the real estate lender, taking all of the real estate-related risk, and conducting due diligence (including review of the availability of the welfare exemption) similar to the investment bankers' review.

Where such bonds are privately-placed, a well-established lender (typically a major national commercial bank or national financial institution) will purchase all of the bonds and

loan the proceeds directly to the project-owning partnership. These lenders conduct extensive underwriting due diligence, including review of the availability of the welfare exemption.

(4) Conventional Financing and/or Loans from Governmental Agencies

Some developers choose not to obtain tax-exempt bond loans, and instead utilize conventional real estate loans (typically from a major national or regional bank) or loans from federal, state or local agencies. Sometimes a developer will obtain both a conventional loan and one or more loans from government agencies. These loans go through the same underwriting (including review of welfare exemption availability) and due diligence scrutiny as discussed above for tax-exempt bond loans.

(5) Conclusion: How Lenders and Investors Police the Property Tax Exemption

As discussed above, the tax credit equity investors, tax-exempt bond credit enhancers/lenders and conventional lenders that provide the lion's share of affordable housing project financing are some of the largest and most sophisticated financial institutions in the world. These investors and lenders subject affordable housing projects to intense underwriting scrutiny at the outset, and intense compliance oversight on an ongoing basis.

Without a predictable welfare exemption, obtainable in a timely manner, lenders would not include welfare exemption savings into their underwriting, making affordable housing projects next to impossible to finance. Moreover, in order to ensure that project-owning partnerships can afford to cover the debt service on loans underwritten to include welfare exemption savings, these lenders provide ongoing welfare exemption compliance oversight, thus providing a backstop to the BOE's and assessors' roles in policing against welfare exemption fraud.

Moreover, the BOE's managing general partner regime requires tax credit equity investors to cede power to nonprofits. These Fortune 500 financial institutions require strict statutory compliance by their partners (including the managing general partner), as a necessary element in protecting their equity investments in affordable housing projects. Contrary to the insinuations of the current regime's critics, these institutional tax credit investors would not enter into a written agreement granting substantial management powers to a nonprofit, and then blithely ignore that agreement in practice.

History and Purpose of R&T 214(g)

Section 214 was enacted in 1945 to implement Section 4(b) of Article XII of the California Constitution, which provides that the California legislature may exempt from taxation "property used exclusively for religious, hospital or charitable purposes and owned or held in trust by corporations or other entities." The original policy rationale for enacting Section 214's "welfare exemption" was to treat certain privately owned property, which was used to provide a charitable activity, in the same manner as publicly owned property which would otherwise be used by government to perform that same charitable function.

(1) Managing General Partner

(a) General Discussion.

In furtherance of the spirit of the exemption, Section 214 was amended in 1987 to add subsection (g), which provides that:

> "[p]roperty used exclusively for rental housing and related facilities and owned and operated by religious, hospital, scientific, or charitable funds, foundations, or corporations, *including limited partnerships in which the managing general partner is an eligible nonprofit corporation . . .*"

shall be entitled to a full or partial property tax exemption, subject to the conditions set forth in Section 214(g) (emphasis added).

The participation of an eligible nonprofit corporation, either as the owner of the property or as the managing general partner of a limited partnership that owns the property, is constitutionally necessary. In other words, without the participation of the non-profit, Section 214(g)'s property tax exemption could not fall under the tax exemption set forth in California Constitution Section 4(b) of Article XII of the California Constitution.

In adopting 214(g), the California legislature did not focus its attention on the attributes of a "managing general partner." Indeed, the highlighted language quoted two paragraphs above was inserted into the proposed text of Section 214(g) a mere twenty-one days before Governor George Deukmejian signed it into law.

The legislative history shows no debate accompanying the addition of the managing general partner concept. Rather, the legislative history reveals a debate focused almost exclusively on the benefit of increasing California's stock of affordable housing, on the one hand, versus the cost associated with the loss of property tax revenues, on the other hand. The addition of the managing general partner concept into 214(g) appears to have been an extension of the economic reasoning behind the bill, summarized succinctly by the Senate Revenue & Taxation Committee in its July 15, 1987 hearing on 214(g):

> "The justification for the exemption would be that the funds which are currently paid in property taxes could better be used in furtherance of the goals of providing low income housing. Also, it may be that some prospective low income projects may not 'pencil out' without the property tax exemption."

(b) What is a "Managing" General Partner?

Notably, the legislature chose the phrase "managing general partner" rather than "general partner." The California Revised Limited Partnership Act contains extensive provisions setting forth the obligations of a "general partner," but makes no mention of a "managing" general partner. By choosing to use the term "managing" general partner, the legislature clearly indicated its understanding that property-owning partnerships could have other, for-profit general partners, so long as the nonprofit general partner was the "managing" general partner.

Certain affordable housing developers have suggested to the BOE that "managing general partners" should be required to provide an expanded array of operational assistance at low income housing projects. Such a requirement would limit the ranks of eligible "managing general partner" nonprofits to a handful of well-capitalized organizations with extensive staffs. This suggestion runs contrary to the text and purpose of 214(g).

Indeed, the legislative history indicates governmental sensitivity to the need to support continued participation by underfunded nonprofit organizations in affordable housing development, and a recognition that the welfare exemption would provide that support. In its Enrolled Bill Report, submitted in late September, 1987, the California Department for Housing and Community Development (the "HCD") recognizes that nonprofit organizations suffer from "limited budgetary conditions." The HCD report goes on to state that the final proposed text of 214(g)would address "the Governor['s] expressed interest in . . . preserving affordable housing and assuring a continued role for nonprofits in affordable housing."

Nonprofit participation in affordable housing is as important today as it was in 1987, and therefore the BOE should resist pressure from an exclusive group of nonprofits calling for rule changes that would increase the expense of nonprofit participation in affordable housing projects.

(2) Use of Property Tax Savings

Under Section 214(g), the owner of the property must:

> "[c]ertify that the funds that would have been necessary to pay property taxes are used to maintain the affordability of, or reduce rents otherwise necessary for, the units occupied by lower income households."

On August 18, 1987, the state assembly amended the bill that was later codified as Section 214(g) to state that property owners should only be required to *certify*, rather than affirmatively *demonstrate*, that the property tax savings are actually helping to maintain affordability or reduce rents. In its August 26 bill analysis, the BOE emphasized the expense of administering a requirement that a property owner affirmatively demonstrate compliance, and explained that "[i]t is not clear how the owner of the property could demonstrate that this requirement is satisfied."

By adopting a "certification" standard rather than the earlier-proposed "demonstration" standard, the legislature moved away from requiring property owners to file financial

information. Such a system would have imposed a nearly impossible burden on owners to track – perhaps on a dollar-for-dollar basis – how property tax savings are applied.

Moreover, 214(g) allows owners to certify that the property tax savings are used to maintain affordability *or* reduce rents. This standard, together with the self-certification regime, evidences the legislature's desire to steer clear of managing exactly how affordable housing projects are run and exactly how property tax savings are applied. Instead, the legislature focused on the broader goal of providing financial assistance for purposes of maintaining and increasing California's stock of affordable rental housing.

In practice, the welfare exemption is absolutely essential in maintaining affordability. As discussed above, the welfare exemption decreases the expenses associated with the ownership and operation of an affordable housing development, and therefore increases the size of the loans that lenders are willing to offer to project owners. Indeed, it is difficult for lenders to underwrite their construction and permanent loans for affordable housing projects without the property tax exemption.

Radical Reforms Are Ill-Advised

Since the BOE's reform proposal was announced in January, a very small but vocal element has suggested that there is systemic and widespread abuse of the welfare exemption. While this is a dramatic proposition, there is simply no evidence whatsoever of such abuse. Indeed the only "evidence" to date consists of anecdotal, third-hand statements by a few members of the public regarding singular examples of perceived abuse. While the BOE should certainly take accusations of fraud seriously, it would be rash to suggest that a few such allegations warrant wholesale changes to the present system.

Another theme running through some of the vocal criticism of the present system is the implicit suggestion that some nonprofits are less worthy than others. This criticism is essentially a "straw man" argument. It diverts attention from the real public policy issue at hand, namely meeting the legislature's mandate for the production of more affordable housing, and tries to focus attention on the perceived qualities of certain nonprofits. This is an entirely subjective and relative matter. There is no litmus test for what is a nonprofit, nor should there be. Moreover, such a consideration is outside of the mission of the BOE and would unnecessarily burden the BOE's already overused resources. The Internal Revenue Service ("IRS") and California's Franchise Tax Board (the "FTB") are the appropriate authorities for such determinations, and these agencies already vet any nonprofit seeking to get involved in the welfare exemption process. Indeed, the BOE's proposed Rule 140 requirements regarding BOE review of a nonprofit's "charitable" purposes, as presented at the BOE's March 2 public meeting, are wholly duplicative of the IRS and FTB functions, and therefore unnecessary.

A final suggestion proffered by a few critics is that only nonprofits involved in the physical operation of an affordable housing project merit the welfare exemption. Presumably, only nonprofits with their own management companies or construction companies could ever meet a stringent application of this test. That proposed standard is entirely inappropriate. The

welfare exemption never has been construed to require such ground level involvement, as discussed in the legislative history section above. Rather, essential management and oversight, as required by the BOE's present system, is the critical test. Requiring a nonprofit to have extensive assets and capital is antithetical to the legislative history, which noted that nonprofits suffer from "limited budgetary conditions."

The Current BOE-Administered System is Achieving the Goals of 214(g)

The current BOE-administered system for assuring compliance with 214(g), as set forth in the BOE's Assessor's Handbook Section *Welfare, Church and Religious Exemptions*, is achieving the original purpose of 214(g): namely, to increase California's stock of affordable rental housing. The BOE's proposed Rule 140, as presented at the March 2 public meeting, would amend the present system by adding additional requirements that are, at heart, substantially similar to the present requirements. The BOE should carefully consider the cost associated with making changes to the present system. Unless change is urgently needed (and this paper has argued that it is not needed), and unless the proposed changes would fundamentally reform the present system (and this paper has argued that the changes proposed by Rule 140 do not), then the BOE should carefully consider the administrative cost of tinkering with a system that already predictably and efficiently achieves the legislature's goals.

With respect to "managing general partner" duties, the BOE's self-certification standard – whereby a managing general partner of a project-owning partnership must certify, under penalty of perjury, that it has certain enumerated management authority and the substantial duties befitting a "managing general partner" – is in keeping with the legislative intent behind 214(g). As discussed above, the legislature consciously chose to adopt a "*certification*" system rather than a "*demonstration*" system for assuring compliance with 214(g)'s requirement that property tax savings be applied towards reducing rents or maintaining affordability. The BOE's managing general partner self-certification standard stays true to the original legislative intent behind 214(g): increasing California's affordable housing stock, rather than imposing governmental control over exactly how affordable housing projects are run.

Furthermore, since 214(g) does not discuss a managing general partner's duties or attributes, there is no clear legislative authorization for the BOE to expand the reasonable list of duties that managing general partners are required presently to attest to on forms BOE 267-L1 and BOE 277-L1. Indeed, the suggestion from a few critics of the current self-certification regime that it allows "nonprofit shells" to obtain property tax exemptions on behalf of for-profit developers is not only factually incorrect – it also runs counter to the very purpose of 214(g).

However, should either the BOE or a county assessor suspect that a particular managing general partner is failing to exercise the managerial control that it is certifying to on forms BOE 267-L1 or BOE 277-L1, both the BOE and the county assessor have the right to audit the potentially offending parties. Forms BOE 267-L1 and BOE 277 L-1 both clearly alert a filing non-profit of this fact, stating in bold letters: "**Welfare Exemption claims and supporting documents are subject to audit by the Board of Equalization and by the Assessor.**" Therefore, in response to any suggestion from critics that some fraudulent managing general

partners are abusing the welfare exemption system, the BOE and the county assessors can and should emphasize that they have the power to audit any and all limited partnerships that obtain a welfare exemption, and the power to revoke improperly obtained welfare exemptions.

Also, from an economic efficiency standpoint, if the property tax exemption is to be accounted for in a lender's initial underwriting, it must be knowable, predictable, and timely obtained. In an era where tax credit investors, credit enhancers and conventional lenders make long-term financial commitments to each affordable housing project that they finance, the predictability of the BOE's bright-line certification process provides a necessary source of predictability. Without that predictability, financial institutions could not rely on the availability of property tax savings, and would reduce the amount of money they are willing to lend or invest in affordable housing projects. A decrease in available funding would only harm California's stock of affordable rental housing.

The BOE's certification system (backed up with the BOE's and the county assessors' audit rights), when coupled with the strict, ongoing oversight provided by tax credit investors, credit enhancers and conventional lenders, assures that managing general partners will continue to wield essential management authority, rather than operating as a "nonprofit shell" for the purposes of obtaining the property tax exemption.

Lastly, the authors of this policy paper would like to support the BOE staff's positions outlined in the BOE's February 24 follow-up letter signed by Dean R. Kinnee. The authors of this paper support the BOE's ongoing efforts to add predictability to the remaining unsettled areas of 214(g) administration and practice.